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Author: Bavadharini KS	**Page No:** 4

After a weak June quarter, recovery to be gradual for SRF

Bavadharini KS
bavdharini.ks@livemint.com

There's been no respite since SRF Ltd's lacklustre performance across business segments in the June quarter (Q1FY24). Since its financial results were announced, the stock fell 2%, contributing to cumulative decline of 5.5% so far in 2023. In Q1, the company's consolidated revenue, at ₹3,338 crore, fell by 14% from a year earlier, while Ebitda fell 30% to ₹696 crore.

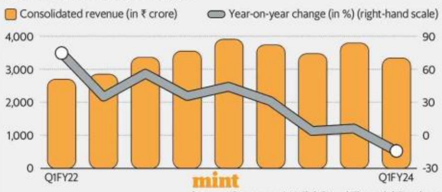
The firm's mainstay chemicals business, which contributed 50% of FY23 revenue, saw an Ebit margin contraction of 750 basis points sequentially to 27.7%. The management said, within chemicals, fluorochemicals was impacted both in terms of volumes and price. Volume was impacted due to mild summers in India, leading to sluggish demand for refrigerant gases. Prices fell primarily due to China dumping products in key geographies. Further, stagnant pharmaceuticals and agrochemical industries adversely impacted the demand for some industrial chemicals.

Besides, the specialty chemicals business performed well despite muted global demand amid an inventory rationalization. But evidently this was not enough to support overall revenue performance. The management expects inventory rationalization to continue for a few more quarters. So, the specialty business growth trends must be tracked, going ahead. SRF's other two segments continued to face headwinds. Its packaging film business saw a steep 83% fall in Ebit, primarily due to a cyclical downturn driven by industry over-capacity. Rohan Gupta, director, Nuvama Institutional Equities, said: "Packaging film business is expected to remain weak for next 3-4 quarters due to unfavourable market condition and continuous margin pressure. Overall, we have cut SRF's FY24 earnings estimates by 12-15% because of the weakness in this segment." Meanwhile, its technical textiles vertical saw pressure in volume of flagship products, nylon tyre cord fabric, due to the low prices of caprolactum, a compound used in synthetic fabric. However, it is encouraging that SRF's capital expenditure plan is on track. It has planned capex in the range of ₹2,800-₹2,900 crore for FY24. Out of it, projects worth ₹1,100 crore are expected to be capitalised for its fluorochemical business. SRF expects fluorochemicals' performance to be better in the second half of FY24.

To be sure, its operating environment remains challenging and recovery in each of the segments is likely to be slow. "Note, while improvement in SRF's business segments is key, stock movement will depend on the improving sentiment of overall chemicals sector, that are quite muted with lot of uncertainty," added Gupta.

Testing times

SRF's revenue fell year-on-year and sequentially in Q1FY24 due to weakness across businesses.



Source: Company, Motilal Oswal Financial Services

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